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No. 90-1029

In The
Supreme Court of the United States
October Term, 1991

Eastman Kodak Company,
Petitioner,
v.
Image Technical Services, Inc., *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR BELL ATLANTIC BUSINESS SYSTEMS SERVICES, INC., AS AMICUS CURIAE SUPPORTING RESPONDENTS

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INTEREST OF AMICUS CURIAE

Amicus Bell Atlantic Business Systems Services, Inc., is the world's largest independent service organization that provides maintenance, repair, and other service for large, medium-sized, and personal computers, including mainframes, peripherals, and other information processing equipment. Bell Atlantic provides service to the owners of equipment manufactured and sold by IBM, Digital Equipment Corporation (DEC), and other companies. Amicus has been in business for more than 25 years.

Bell Atlantic faces a similar problem in its industry to the problem faced by respondents in theirs. To ensure full service on complex computer equipment—which may

cost millions of dollars and, because of periodic upgrades provided by the manufacturer, have a useful life of more than 10 years—a service provider like Bell Atlantic, or the equipment owners themselves, must have reasonable access to parts, diagnostic software, training materials, and so-called "engineering changes" (or "field change orders") from the manufacturer. Bell Atlantic's servicing business—indeed, the entire independent service business for large and medium-sized computers that has developed over the past several decades—could be seriously threatened, and consumers seriously harmed, if manufacturers were permitted to gain control over service on their equipment by exploiting these needs through exclusionary policies like the Kodak policies at issue in this case.[1]

INTRODUCTION AND SUMMARY OF ARGUMENT

As it comes to this Court, this case involves three distinct markets, or levels of markets: equipment; parts to be used for repairing or upgrading the equipment; and service on the equipment. Respondents are independent service organizations (ISOs) who in the early 1980s developed businesses of servicing Kodak copying and micrographic equipment. During that time, according to their allegations and evidence, they and their customers were able to buy parts from Kodak that were essential to providing full service to owners of Kodak equipment. This suit challenges Kodak's attempt to monopolize the service of its equipment by adopting, in 1986, new policies of (a) tying parts to service, *i.e.*, selling parts to equipment owners only if they buy service from Kodak or perform their own service, and (b) refusing to sell parts to ISOs.

Respondents challenge those policies as violating the Sherman Act, 15 U.S.C. §§ 1, 2—in particular, Section 1's *per se* rule against tying arrangements, and Section

[1] The parties have consented to the filing of this brief. Letters to that effect have been filed with the Clerk of the Court.

2's prohibition of monopolization and attempted monopolization. This case has not been tried, and so the Court must take respondents' evidence and the inferences it would support as given. *See United States v. Diebold, Inc.*, 369 U.S. 654, 655 (1962). Kodak therefore asks this Court to adopt a flat rule, as a matter of law, that the presence of competition in the equipment market precludes market power in the separate parts or service markets—even though Kodak's policies produce higher service prices to consumers. But Kodak has not offered sufficient justification for adoption of its theory as a rule of law. Facts are plainly in dispute, and respondents are entitled to a trial.

A. Under the standards of tying and monopolization liability set forth by this Court, respondents have, for purposes of the present petition, made out the basic elements of their claims. Kodak has used its unique control over key parts to force Kodak equipment owners to buy service from Kodak that they would prefer to buy from ISOs at substantially lower prices—a tying arrangement between the parts and service markets. Moreover, after selling parts to independent service providers for several years, Kodak ceased such sales of its unique parts in an effort to eliminate competition from ISOs and monopolize service. The effect has been to impose higher prices on consumers by eliminating their competitive alternatives. These facts satisfy the standards for liability under *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (tying arrangements), and *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) (monopolization).

Kodak asks this Court for a new limitation on those standards, suggesting that the Court hold, as a matter of law, that the higher prices to consumers—facially anticompetitive harms—cannot actually be anticompetitive. The reason, Kodak urges, is that any market power in the two "aftermarkets" being tied together by Kodak, the

markets for parts and service, is made impossible by the existence of competition in yet a third market—the market for new equipment. Kodak argues that it is entitled to summary judgment on that theory under *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), but this case is notably different from that. There, the plaintiffs were challenging *low* pricing, which antitrust law promotes, on a speculative economic theory that consumers would ultimately be harmed. In the present case, by contrast, Kodak's conduct results in immediately higher prices to consumers, which antitrust law seeks to prevent, and Kodak is urging adoption of a speculative economic theory to excuse that conduct. Unlike the argument advanced by the plaintiffs in *Matsushita*, moreover, respondents' argument for antitrust liability does make economic sense.

B. Kodak's theory for excusing the elimination of competition rests on a simple factual assertion: that lost equipment sales will *always* outweigh the gains from supercompetitive pricing of parts and service, so that no rational equipment seller would engage in such pricing (and, hence, Kodak's elimination of competition must not, in the end, be truly anticompetitive). But Kodak offers no reason why the balance of gains and losses will always tip decisively against the seller, and this Court cannot merely assume the truth of the factual claim. On the contrary, there are two significant barriers to consumer choice that may substantially undermine the disciplinary effect that competition for equipment sales would otherwise have on pricing in aftermarkets for parts and service.

The first such barrier involves information costs. In order to respond to supercompetitive prices in an aftermarket, a buyer in the equipment market must be aware of those prices and also be able to integrate that knowledge with all of the other complex information about the product that goes into comparative "lifecycle" pricing

(that is, judging price by adding initial cost to projected costs of parts and service over the life of the product). These tasks are often prohibitively expensive to accomplish: the value of the information often does not justify the cost of acquiring it. And in the absence of effective lifecycle pricing, Kodak's theory that equipment competition will prevent exploitation in the aftermarkets collapses.

The second defect in Kodak's economic theory involves the cost of switching to new equipment. Once a consumer invests in a long-life product, there may be little freedom to stop using it even if the consumer is forced to pay supercompetitive prices for parts and service: the option of changing to another product may be too costly. Such high switching costs give sellers in some markets a cushion to use to collect supercompetitive profits.

Kodak's answers to these obvious weaknesses in its fundamental claim are inadequate to justify a flat legal rule that forecloses inquiry into the essential facts. Kodak's principal defense is that there are always some price-sensitive customers that it cannot exploit and, therefore, it "must" and "does" charge competitive lifecycle prices to all of its customers. Kodak Br. 23. But the record does not compel adoption of the critical assumption that price discrimination among customers is not possible. Indeed, Kodak admits that it allows customers to service their own equipment, which necessarily means that it charges different lifecycle prices to some customers. More generally, in markets for long-life, complex products, there are usually many ways in which sellers can discriminate between customers who are fully able to "comparison shop" or switch products and those who are not.

Kodak's other defense rests on various asserted procompetitive justifications for its policy—quality control, inventory reduction, and the avoidance of free riding. But that defense has little to do, as a logical matter, with

Kodak's theory that equipment competition alone is enough to mean that it could not possibly have market power in aftermarkets. In any event, there is a genuine issue of fact as to the validity of the asserted justifications. Indeed, it is difficult to square them at all with Kodak's willingness to allow customers to service their own equipment.

ARGUMENT

As the case comes to this Court, respondents have made out the basic elements of antitrust liability under this Court's precedents on tie-ins and monopolization, showing immediate harm to consumers by the direct and deliberate foreclosure of competition in the service market. Kodak seeks to overcome respondents' case by advancing a new legal rule that purports to explain away the immediate competitive harm as not quite what it seems—as really not the result of market power after all. But that rule rests entirely on a speculative, factual, economic assertion about how much discipline competition in one market (equipment) will actually impose on exploitation of monopoly control in other markets (parts and service). That assertion, far from being obviously and necessarily correct, is clearly open to serious question in various circumstances, including the circumstances presented in this case. There can be no justification for precluding the essential factual inquiry into Kodak's theory by adopting Kodak's proposed rule as a matter of law.

A. Under Established Standards, Respondents Have Raised Triable Issues On The Necessary Elements Of Tying And Monopolization Liability.

There is no real dispute in this Court about the essential elements of either an unlawful tie-in between parts and service or illegal monopolization (or attempted monopolization) of Kodak parts or service.[2] Nor, given the

[2] The law of attempted monopolization is slightly different from the law of monopolization—*e.g.*, monopoly power need be dangerously probable rather than actually present—but such differences are not relevant to the arguments presented by Kodak. If respondents are entitled to a trial on their monopolization claim, they are likewise entitled to a trial on attempted monopolization. We therefore limit our discussion to monopolization.

posture in which this case comes to the Court, can it be seriously denied that respondents have shown enough to go to trial on those elements. Kodak is therefore in the position of seeking to deny liability, without affording respondents a trial, based on a single argument that facially anticompetitive consequences should be excused because, as a matter of law, Kodak *cannot* exercise market power in the parts or service markets.

1. *Legal Standards.* This Court's precedent makes clear the basic elements of an illegal tying arrangement. There must be two distinct products and "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier." *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958). Such a tying arrangement is subject to condemnation under the long-standing *per se* rule if it affects a substantial volume of commerce and if the seller can exploit "its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984). *See id.* at 9-10 & nn.13, 14, & 15 (citing cases recognizing the rule and legislative history supporting it in the context of § 3 of the Clayton Act, 15 U.S.C. § 14); *id.* at 16. If "market power" over the tying product (here, parts) is used to force unwanted purchases of the tied product (here, service), the Court's "cases have found the tying arrangement to be unlawful." *Id.* at 14.[3]

[3] Lower courts, including the Ninth Circuit, have held that a tie-in that falls under the *per se* rule may nevertheless be lawful

The basic harm caused by illegal tying arrangements is well recognized: "if [market] power is used to impair competition on the merits in another market, a potentially inferior product may be insulated from competitive pressures." *Jefferson Parish*, 466 U.S. at 14 (footnote omitted, citing sources). *See generally* 9 P. Areeda, *Antitrust Law* ¶¶ 1703-1718, at 32-253 (1991). If a tie-in gives a seller monopoly power over the tied product as well as the tying product, the seller may be able to increase overall monopoly profits above what it is collecting or can collect in the tying-product market. Most directly, "the profits attainable from coordinated monopoly pricing of two goods which, for example, are complements in use, will generally be higher than those realized by setting a monopoly price for each commodity separately."[4] The tie-in may also "facilitat[e] price discrimination, thereby increasing monopoly profits over what they would be absent the tie." *Jefferson Parish*, 466 U.S. at 15 (footnote citing sources omitted).[5] By monopolizing two markets rather than one, moreover, the tying seller may succeed in raising entry barriers in one or the other market, thereby strengthening or extending its market

"if implemented for a legitimate business reason and if no less restrictive alternative is available." Pet. App. 12A-13A (internal quotation marks omitted); *see Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1349 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988).

[4] F.M. Scherer, *Industrial Market Structure and Economic Performance* 582 (2d ed. 1980) (footnote giving citation omitted); *see* F.M. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* 566-67 (3d ed. 1990); Wollenberg, *An Economic Analysis of Tie-In Sales: Re-examining the Leverage Theory*, 39 Stan. L. Rev. 737, 747-50 (1987).

[5] *See also* F.M. Scherer, *supra*, at 582-83; F.M. Scherer & D. Ross, *supra*, at 566-67. Price discrimination is harmful to consumers because it allows the seller to extract more revenue by charging above-market prices to those buyers who will pay such prices while continuing to charge other buyers the market price. *See* Wollenberg, *supra*, at 750-52 (price discrimination gives the seller some of the "consumer surplus").

power in either one alone.[6] In addition, a tie-in may facilitate evasion of a legal restriction applicable only to the tying product, such as the Robinson-Patman Act, 15 U.S.C. § 13, which restricts price discrimination in sales of "commodities" but not service.[7]

With respect to monopolization, the Court has likewise made clear the essential elements of a violation. Two elements must be proved: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966), *quoted in Aspen Skiing Co. v. Aspen Highlands Skiing*

[6] *See Jefferson Parish*, 466 U.S. at 14; *id.* at 36-37 (O'Connor, J., concurring in the judgment); *Fortner Enters. v. United States Steel Corp.*, 394 U.S. 495, 509 (1969). As Judge Breyer explained for the First Circuit in *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 795 (1988), a tying arrangement may allow a seller to "build a strong market position in Product B . . . [that] may increase its power to charge high prices in respect to Product A."

> If a monopolist of patented can-closing machinery, for example, insists, as a condition of selling his machines, that their purchasers buy his cans, he will likely soon have a monopoly in cans as well as machines. And, that fact—the fact that he controls *both* cans and machines—may make his monopoly safer from competitive attack when his patent on the can-closing machinery expires. A new competitor would then have to enter *both* levels of the business (cans and machines) to deprive him of monopoly profits. And, this added security may enable the machinery monopolist to charge higher prices. The tie, by permitting the Seller to extend its market power from one level to two, may thereby raise entry barriers, providing security that helps a monopolist-seller further harm the consumer.

Id. at 795-96.

[7] *See* F.M. Scherer, *supra*, at 583; F.M. Scherer & D. Ross, *supra*, at 567; Bowman, *Tying Arrangements and the Leverage Problem*, 67 Yale L.J. 19, 21-23 (1957).

Corp., 472 U.S. 585, 596 n.19 (1985). As to the second element, while this Court has recognized the general right of even a monopolist to refuse to deal with competitors, it has held that the right does not automatically extend to a monopolist's decision to terminate an existing relationship with a competitor where the termination effects "an important change in a pattern of distribution that had originated in a competitive market and had persisted for several years." *Aspen*, 472 U.S. at 603; *see Lorain Journal Co. v. United States*, 342 U.S. 143, 155 (1951). Rather, such an act may constitute the required "exclusionary conduct" if it is not supported by valid business reasons but, instead, "impair[s] competition in an unnecessarily restrictive way." *Aspen*, 472 U.S. at 605 (footnote omitted, citing 3 P. Areeda & D. Turner, *Antitrust Law* ¶ 626b, at 78 (1978)).

2. *The Facts in This Court.* Because of the posture in which this case is before the Court—prior to any trial, with Kodak seeking to prevail on a simple legal ground—the sufficiency of respondents' proof of the basic elements of both tying and monopolization liability, under the familiar standards, is not truly in dispute here. As to the tying arrangement between parts and service, the existence of two distinct product markets—one for Kodak parts, another for Kodak service—is not at issue: the court of appeals found this to be a factual question (Pet. App. 6A), and Kodak's tying argument proceeds on the assumption that two products are present (Kodak Br. 14-32).[8] *See also* U.S. Br. 4 n.3. Similarly, it is not open

[8] Kodak's brief includes one footnote on the issue (Kodak Br. 15 n.3), but the question has not been properly raised in this Court, and Kodak's passing discussion is wrong for several obvious reasons. To begin with, it ignores the holding of *Jefferson Parish* that whether two products exist must be judged from the consumer's standpoint, based in part on whether the products are in fact sold separately or paid for separately. 466 U.S. at 19-23. Plainly, that test raises a factual question in this case, for there is evidence

to question in this Court that at least some *Kodak* parts are essential to any equipment owner's ability to receive full service: again, Kodak's argument has not rested on challenging respondents' evidence to that effect. *See* Pet. App. 7A ("many Kodak parts are unique and available only from Kodak"); *cf.* U.S. Br. 12 & n.10. To put this last point another way, Kodak effectively has a 100% share of the relevant tying-product market.

There is no dispute that Kodak's "arrangement affects a substantial volume of interstate commerce in the tied product" (service). Pet. App. 4A n.2. More pointedly, respondents have alleged and offered evidence that Kodak's control over the market for the parts necessary to any equipment owner's full-service needs has in fact forced undesired purchases of Kodak service. Again, Kodak's argument in this Court does not rest on any challenge to respondents' claims that consumers switched to Kodak's

that service and parts have been sold separately in the past (Pet. App. 6A; J.A. 99, 152, 349-50, 415-16) and still are sold separately to self-service equipment owners (Kodak Br. 3).

Kodak quotes the test articulated by Justice O'Connor—that "the tied product must, at a minimum, be one that some consumers might wish to purchase separately *without also purchasing the tying product.*" 466 U.S. at 39. But Kodak gets even that test backwards, claiming that "there is no demand for parts other than to provide service." Kodak Br. 15 n.3. The quoted test asks the opposite question: whether some consumers would buy service without parts. The answer to that question plainly is yes, because much service does not require parts. Moreover, even under Kodak's reversed test, Kodak is wrong: some consumers, including respondents, would wish to purchase parts without service.

In any event, the test articulated by Justice O'Connor cannot be applied by asking if consumers *as a whole* would buy the tied product without *ever* having bought the tying product: the test asks if *some* consumers would buy the tied product without *at the same time* buying the tying product. Otherwise, the test would make cameras and film, or cans and can-closing machines, the same products. Yet the real economic harm at which tying law aims is present in such cases. *See* note 6, *supra* (quoting from *Grappone*). Thus, the *Jefferson Parish* majority pointed out that the Court has long found such complementary products to be distinct. 466 U.S. at 19 n.30.

service even though it was much higher priced (double, in some cases) than preferred, higher quality service of ISOs, and that many ISOs were forced out of business while others lost substantial revenues. *See* J.A. 341, 414, 420-27, 474-76, 458-59, 463, 469, 482-84, 493-96, 501-02, 514, 614. Under the recognized tying-law standards, respondents thus have earned a trial on their claim of "forcing" through a tying arrangement between parts and service. *See Jefferson Parish*, 466 U.S. at 17 ("When the seller's share of the market is high, or when the seller offers a unique product that competitors are not able to offer, the Court has held that the likelihood that market power exists and is being used to restrain competition in a separate market is sufficient to make *per se* condemnation appropriate.") (citing *Fortner*, 394 U.S. at 504-06 & n.2, and *Times-Picayune Publ. Co. v. United States*, 345 U.S. 594, 611-13 (1953)).[9]

Respondents also have earned a trial on their monopolization claim under the recognized standards. Not only must it be accepted here that Kodak has an effective monopoly in the market for certain essential parts, but it is not disputed in this Court that Kodak took exclusionary action to maintain its parts monopoly (*e.g.*, J.A. 120, 428-29, 468, 496; Lodgings 150, 178). Nor is it open to question that Kodak is using its control over parts to strengthen its monopoly share (80-95%, *see* J.A. 345) of the Kodak service market.[10] And, perhaps most tell-

[9] Kodak does not argue that it is entitled to summary judgment on respondents' tying claim based on alleged business justifications, a defense that some lower courts recognize. *See* note 3, *supra*. Any such defenses, moreover, plainly raise factual issues that are hotly disputed. *See* pages 24-27, *infra*.

[10] Kodak lamely raises questions about some of those propositions (Kodak Br. 33-38), but it cannot seriously be denied that respondents have met their burden of raising genuine factual issues on the monopoly power question for trial. For example, in seeking to deny that Kodak service or parts constitute relevant markets, Kodak relies on this Court's statement in *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 393 (1956), that a single brand of a product does not *automatically* form its own market. Kodak Br. 33-34. That

ingly, respondents have offered evidence that, like the defendant in *Aspen*, Kodak terminated an existing relationship (Kodak sold parts to ISOs and their customers prior to 1986, *see* J.A. 99, 152, 349-50, 415-16) and thereby effected "an important change in a pattern of distribution that had originated in a competitive market and had persisted for several years." *Aspen*, 472 U.S. at 603. What remains, therefore, is the question of procompetitive business justification for the new Kodak policies. That question, however, cannot conceivably be resolved on summary judgment, for the validity and sufficiency of Kodak's asserted business justifications—quality control, inventory control, avoidance of free-riding—are obviously in serious factual dispute. *See* Pet. App. 12A-14A, 17A-18A.

3. *Kodak's Theory*. It is against this background that Kodak makes its argument for relief from this Court. Kodak insists that, notwithstanding its monopoly *share* of the relevant parts market and notwithstanding the elimination of the substantially lower priced, high-quality alternatives for Kodak service customers, Kodak does not actually have market *power*, in that it cannot "control prices or exclude competition." *duPont*, 351 U.S. at 391. In other words, Kodak is contending that the higher service prices it forced on Kodak customers are not super-

principle is obviously correct, but it cannot help Kodak. In this case, there is a genuine factual issue as to whether Kodak parts or service markets exist in real economic terms—that is, when "appraised in terms of the competitive market for the product." *duPont*, 351 U.S. at 393. It is the choices a Kodak equipment owner has available that determine the relevant market (*Jefferson Parish*, 466 U.S. at 19-23), and Kodak is not entitled to summary judgment on that question in the face of the evidence that certain necessary parts are uniquely available from Kodak (*see* Pet. App. 7A, 18A-19A). Notably, Kodak's discussion of this last point delicately avoids a direct denial that some key parts are uniquely available from Kodak. *See* Kodak Br. 37-38 (carry-over sentences). Nor does Kodak deny that it adopted its policies in order to eliminate independent competition in the service market. *See* J.A. 91-92, 422, 426-27, 455-56.

competitive prices. Kodak bases this claim not on any direct analysis of the parts and service markets, but instead on an inference it asks the Court to draw about those markets from a third market—the market for the equipment. In particular, Kodak urges this Court to hold, as a matter of law, that the existence of competition (the lack of market power) in the *equipment* market makes it impossible for Kodak to exercise market power in the *parts* market (or, therefore, the *service* market). Kodak Br. 14-33. Kodak summarizes its proposed rule of law as follows: "interbrand equipment competition precludes any finding of monopoly power in derivative aftermarkets." Kodak Br. 33.

Kodak rests its claim on this Court's holding in *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986), that an antitrust plaintiff cannot defeat a motion for summary judgment if its claim rests on a theory that "simply makes no economic sense." We fully endorse that principle, but even on first blush its application here is quite different from its application in *Matsushita*. There, conduct that produced direct and immediate benefits to consumers—*low* pricing—was challenged (as predatory pricing) on the "speculative" theory that such conduct was in the long run harmful to consumers. *Id.* at 588. Because the challenged low pricing was "the very conduct the antitrust laws are designed to protect," the Court said that the plaintiffs had a particularly heavy burden of persuasion to justify forcing the case to a burdensome trial. *Id.* at 594. This case is precisely the opposite: conduct that produces direct and immediate harm to consumers—higher (service) prices, which antitrust law generally aims to prevent—is being defended on the speculative theory that such conduct is, from a broader perspective, actually beneficial to consumers.

In these latter circumstances, the Court must take special care not to adopt as a legal rule barring liability an assertion about economic behavior and market functioning that rests on factual assumptions that may not mirror

reality. Here, as we next argue, Kodak's broad rule cannot be justified as a matter of law, for respondents' claim does make economic sense. Indeed, there are obvious reasons why Kodak's assertion may be false—why it is far from "inherently implausible" (Kodak Br. 30) to claim that the supposedly perfect inter-market disciplining mechanism relied on by Kodak may not function as Kodak suggests.

B. Competition In The Product Market Provides No Guarantee That A Seller Like Kodak Will Not Exercise Market Power In Charging For Parts And Service.

Kodak's theory for disregarding the facially anticompetitive effects of its policies rests on a straightforward factual claim:

> If Kodak raised its parts or service prices above competitive levels, potential customers would simply stop buying Kodak equipment. Perhaps Kodak would be able to increase short term profits through such a strategy, but at a devastating cost to its long term interests.

Id. at 12. As that passage itself indicates, and as Kodak elsewhere makes even more explicit, whether supercompetitive parts or service pricing is economically sensible for Kodak turns on a balancing of gains and losses: whether its gains from overcharging for service outweigh its losses in new sales. *See* Kodak Br. 25 (the question is whether "Kodak can make more total profit by overcharging its existing customers for service than it will lose as its new and repeat product sales dry up").[11] Where Kodak errs is in simply asserting, as *a priori* true, that the losses will always exceed the gains. *See, e.g., id.* at 12 ("devastating cost"), 22 (future loss in equipment sales "dooms" supercompetitive parts or service pricing), 26 ("inconceivable" that losses "would be outweighed" by gains). But the question, of course, is a factual one—how many

[11] The quoted statement is inaccurate in that it ignores gains from overcharging the *new* service customers that Kodak acquires by driving ISOs out of business.

equipment sales will be deterred, and at what per-sale loss, as consumers buy competitors' equipment? And the answer cannot merely be asserted or assumed. Indeed, there are obvious reasons why the exploitation of parts and service customers will not automatically lead new purchases to "simply stop" or to "dry up" so severely that antitrust law must assume, based on the ineluctable laws of economics, that no such exploitation can take place.

1. *Information Costs.* Kodak's inter-market disciplining mechanism depends entirely on the ability of consumers to integrate into their equipment-purchase decisions information about the prices being charged for parts and service—that is, to engage in lifecycle pricing at the point of initial purchase. Moreover, for Kodak's argument to work, such lifecycle pricing must be practical even if there is no competitive alternative to Kodak parts or service. This Court cannot accept that theory as legally compelled.

The plain fact is that difficulties in acquiring and using information may severely limit the extent to which new sales will be impaired by any supercompetitive aftermarket pricing. In markets like those at issue in this case (or in the high-end computer market), the information costs, and hence the practical difficulties with lifecycle pricing, are dramatically high.[12] And those difficulties cannot be swept aside, as a matter of law, by the assertion that "highly sophisticated customers" (Kodak Br. 23) will have adequate information to ensure that all customers are protected from supercompetitive pricing, for it is clear that sellers like Kodak can readily set different lifecycle prices for sophisticated purchasers from the monopoly prices that they are able to extract from unsophisticated customers.

a. The initial flaw in Kodak's analysis is that it rests on the untested assumption that potential purchasers of a

[12] Kodak vastly understates the matter when it acknowledges that consumers do not "ever have perfect information." Kodak Br. 24.

product will be able to know whether the pricing of parts and service is at a supercompetitive level and use that information in comparing the lifecycle prices of competing sellers of the product. That model of economic behavior seems perfectly plausible with respect to fungible products such as sugar or rice, which are purchased at a single point in time and then simply consumed. For such products, lifecycle costs roughly equal original cost. But the information and price-comparison costs are on their face much higher for non-fungible products such as copiers or computers: each such product may offer different capabilities that are hard to compare; the lifecycle costs are spread over many years and include many elements; and some of those elements (*e.g.*, future service) simply cannot be priced years before they are purchased. In this type of market, the barriers to acquiring information faced by consumers trying to make effective lifecycle pricing decisions may well be too high to guarantee competitive pricing in aftermarkets.[13]

Thus, consumers may not even be able to determine whether they are being charged supercompetitive prices

[13] The Court in *Jefferson Parish* recognized that information barriers may constitute a market imperfection. 466 U.S. at 15 & n.24 (tie-in may cause economic harm where consumers suffer from "an inability to evaluate the true cost of either product when they are available only as a package"). *See* Craswell, *Tying Requirements in Competitive Markets: The Consumer Protection Issues*, 62 Boston L. Rev. 661, 676 (1982) ("It is by now fairly well-known that sellers tend to engage in less price competition where buyers have difficulty making price comparisons.") (footnote citing, *inter alia*, Salop, *Information and Monopolistic Competition*, 66 Am. Econ. Rev. 240 (1976), and Stigler, *The Economics of Information*, 69 J. Pol. Econ. 213 (1961)).

Kodak states (Kodak Br. 23) that *Jefferson Parish* rejected reliance on imperfect information, but that is wrong. The Court indicated that consumers' *indifference* to price (because of medical insurance) undermined any claim of forcing. 466 U.S. at 27-28. Here, as in the usual situation, consumers care about aftermarket prices but are hampered in their ability to acquire the necessary information in a cost-effective manner.

in a monopolized aftermarket. Indeed, by barring competitors from its service market, a company like Kodak eliminates the only readily available form of price comparison for service of *its* products. Kodak's proposed alternative—that its competitors in the equipment-sales market will apprise customers of its unduly high prices (Kodak Br. 26 n.11)—is dubious at best. Such a competitor is unlikely to have reliable information about the lifecycle costs of equipment it does not service, especially where the equipment is complex and individual customers' experiences vary widely. And in product markets that are served by a few large sellers, the sellers may end up tacitly concluding that a uniform practice of supercompetitive pricing would best serve all of them. *See generally* 2 P. Areeda & D. Turner, *Antitrust Law* ¶ 404b, at 273-79 (1978) (oligopoly pricing).[14]

Even if consumers were able to obtain information about the servicing costs of each brand of equipment, they would still have to integrate that information into a comprehensive comparative lifecycle pricing decision. (After all, even if Kodak charges more than Xerox for service, that fact may be of no consequence if, for example, Xerox charges more for parts or if its machines break down more frequently.) The job of making lifecycle pricing comparisons requires a great deal of information. A consumer must acquire (1) initial purchase information—*e.g.*, prices, features, quality, and available warranties; (2) post-purchase information—*e.g.*, price, quality, and availability of products needed to use, upgrade or add to the initial equipment, as well as service and repair costs, including frequency of repair, magnitude of "down-time," and losses incurred from down-time; and (3) residual-value information—*e.g.*, the longevity of product use and its potential resale or trade-in

[14] In this case, for example, respondents allege that Kodak's only real competitor for high-volume copiers (Xerox) has adopted policies like Kodak's, designed to capture service of its product.

value. To make matters worse, this large body of information frequently changes during the life of a product—especially in a technologically advanced field—as companies change service prices over time and bring new products into the market, with more advanced features, a decreased need for repair, or new warranties. And lifecycle costs vary from customer to customer, as their types and degrees of equipment use vary.[15]

It is often quite difficult and expensive for consumers to obtain this complex body of information. Moreover, the expense must be judged in light of how important parts and service costs are in buying the product. If such costs are small relative to the equipment price (*e.g.*, for some large computers, annual service costs may be only 2% of equipment price), or if consumers are far more concerned about capabilities of the equipment than service costs, the relative value of the necessary information may be quite low. In such circumstances, it is especially unlikely that the information will be compiled.

Because it is so costly to do the necessary research for effective lifecycle pricing—including long-term studies of breakdown and repair costs—only large-volume users typically can afford to undertake it. The few customers who are likely to possess this information, however, are unlikely to share it with other customers (including *their* competitors), precisely because it is so valuable. In view of these market realities, it has long been considered indisputable that the best source of market pricing information is the charge made by competitors for the

[15] These kinds of lifecycle costs, in fact, are not even identical for each one of a given kind of product—some are "lemons," breaking down more frequently or taking longer to fix. Thus, a shopper must make predictive judgments not only about average lifecycle prices but about the range of such prices for particular brands as well. Further, some of these lifecycle costs are likely to be customer-specific: it is more costly for a travelling salesperson to have to leave his or her car in the shop for several days than it is for a retiree who drives infrequently.

same product or service. But that, of course, is exactly the information that Kodak is eliminating by its policies designed to destroy ISOs.

b. Kodak argues that none of this undermines its proposed legal principle because there will always be some large-volume, sophisticated purchasers who will do the comparative studies and insist that Kodak charge only competitive lifecycle prices or else lose their business. According to Kodak, such customers will hold down the lifecycle price for *all* Kodak customers, including those who have already bought equipment and now seek only parts and service. Kodak Br. 23. But, although normally such a group of informed consumers will exist, there are economically plausible reasons to doubt that sophisticated purchasers will ensure that competitive prices are charged to unsophisticated purchasers as well.

There is simply no reason to assume that a seller cannot price discriminate between reasonably well-defined groups of potential customers, such as the sophisticated and unsophisticated. On the contrary, one of the virtues of complex lifecycle pricing is precisely that it permits numerous opportunities for price discrimination between groups of customers. The more complex the product, the greater the opportunity to vary the contents of the "package" (Kodak Br. 23) being sold to different consumers, including different elements in the package (*e.g.*, warranties) or offering price discounts on different components. And for present purposes, the "sophisticated" are likely to be easy to identify: they are the high-volume customers for whom it is economically worthwhile to acquire the complex information needed for comparative lifecycle pricing. Such customers, indeed, may identify themselves.

This case seems to provide an illustration of exactly that kind of price discrimination. In particular, Kodak's policy is to sell parts to customers who service their own

equipment. Those companies that will sensibly be able to afford their own service staff, however, are likely to be high-volume users—*i.e.*, the same companies that are likely to be able to engage in complicated lifecycle decisionmaking in the first place. The suggestion that Kodak's self-service exception is intended to facilitate price discrimination is especially strong here, because Kodak has offered no alternative reason for the exception.[16]

2. *Switching Costs.* In addition to the magnitude of the pertinent information costs, there is a second significant reason why the charging of supercompetitive aftermarket prices will not necessarily lead to more-than-offsetting reductions in sales of the product. Any reduction in sales is directly limited by the potentially high cost of switching to a different product, a phenomenon the court of appeals described as the lock-in effect. Pet. App. 81. *See* 2 P. Areeda & D. Turner, *Antitrust Law* ¶ 519a, at 349 (1978) (shifting to substitute product may be costly because necessary complementary investments—*e.g.*, in factories—may be product-specific). The fewer the sales losses, of course, the more favorable to the seller is the loss-gain balance that determines how unlikely monopoly pricing in the aftermarkets truly is.

Kodak claims that it would be "impossible" for a seller in a competitive product to exploit locked-in customers because " 'as soon as word [of the tie-in] got out no one

[16] By providing for such an exception in the service market, Kodak's policy may also enable it to avoid the restrictions on price discrimination in the parts market that are imposed by the Robinson-Patman Act—restrictions that may limit Kodak's ability fully to exploit its monopoly power in the parts market alone. *See* page 9, *supra*. Further, in highly technical markets, the tying of service and parts may also add to market power in parts by helping the seller influence or control its customers' information about the competition: service providers will often be the principal source of advice about which parts (or, indeed, equipment) a customer can or should buy.

would buy' " the original product. Kodak Br. 25-26 (quoting *Parts and Elec. Motors, Inc. v. Sterling Elec., Inc.*, 866 F.2d 228, 236 (7th Cir. 1988), *cert. denied*, 110 S. Ct. 141 (1989) (Posner, J., dissenting)). But even if the "word" did indeed "get out" immediately (as often it will not, *see* pages 16-21, *supra*), it hardly follows that a seller could not enjoy monopoly profits in its aftermarkets. That determination depends on just how locked-in a market is—the magnitude of switching costs and the size of the locked-in base relative to the number of new purchasers—as well as on whether a seller can price discriminate between its locked-in customers and potential new customers. Both of those inquiries raise questions of fact, not law.

In the first place, the extent to which customers' switching costs are high clearly varies from one type of equipment to another. For example, if a toaster-oven manufacturer tried to charge monopoly prices for service or parts, customers would readily change to another brand because the cost of switching is relatively low. By contrast, for the purchaser of a sophisticated computer, the cost of switching is frequently prohibitively high. That is so partly because the equipment itself is expensive (often costing millions of dollars) and bought with the understanding that it will be used for many (perhaps 10 or more) years. In addition, the computer likely will be part of a larger system including other equipment (*e.g.*, printers, disk drives, memory devices, etc.) designed to be compatible with the computer; expensive software may have been written or purchased specifically for the installed brand of computer; and it may be extremely expensive to retrain a workforce to use a different kind of computer system. An owner of such equipment would incur substantial costs in shifting to new equipment, costs that may exceed the burden of even many years of supercompetitive parts or service pricing.

The relative balance of gains and losses from exploiting customers that face high switching costs, of course, depends on the size of that locked-in base compared to the number of new purchasers. In a developed market for long-life products, the locked-in base typically will be large relative to the pool of new buyers. For example, most potential purchasers of large computers today already own such equipment. As a result, the market for complex computers is locked-in to a very high degree: the large majority of potential customers have already chosen the manufacturer that they intend to stay with, at least barring major, unforeseen circumstances; and most purchases are made by prior owners of the same manufacturer's computers. The existence of such a significant, market-wide lock-in provides a seller with a substantial degree of shelter for supercompetitive pricing in its aftermarkets. In such circumstances, there is no basis for excluding the possibility, as a matter of law, that a seller can make more money by charging such prices than it would lose as a result of foregoing new customers who are aware of, and deterred by, this pricing practice.

Beyond that, a seller may even be able to avoid this choice altogether, or to a large extent, by discriminating in price between locked-in and new customers. For example, a seller with a significant installed base can offer new customers an overall lifecycle price that is competitive by pricing its equipment below the market price and then recouping the loss by charging them the supercompetitive price on parts and service that is charged to the installed base. Alternatively, if the cost of service and repair deters a large number of new equipment sales, the seller can address that issue directly by offering a lifetime warranty or long-term service agreement that is not available to customers who are locked in.

Kodak's ability to take advantage of a lock-in effect would seem to be closer to that of a large-computer manufacturer than to that of a toaster-oven manufacturer. Respondents have alleged price discrimination (*see* pages 20-21, *supra*) and a substantial lock-in effect at least for

certain of the submarkets for expensive Kodak equipment. *See* J.A. 424-25, 467, 487-88. Kodak's argument in this Court, far from showing persuasively that no triable issue is presented on that factual question, concentrates on urging that the lock-in effect is essentially irrelevant. *See* Kodak Br. 24-27. For Kodak to prevail, it would have to be clear beyond genuine factual dispute that no significant switching costs, and no price discrimination, gave Kodak a cushion for the charging of supercompetitive prices. No such conclusion can be justified here.

3. *Procompetitive Justifications.* Kodak offers three "procompetitive" justifications for its exclusive service policy, claiming that this proffer defeats respondents' monopolization and attempted monopolization claims.[17] "There are three main business reasons for Kodak's refusal to sell parts to ISOs: (1) to promote interbrand equipment competition by allowing Kodak to stress the quality of its service; (2) to improve asset management by reducing Kodak's inventory costs; and (3) to prevent ISOs from free riding on Kodak's capital investment in equipment, parts and service." Kodak Br. 6; *see id.* at 6-8, 38-40. Initially, however, such policies cannot establish, as a logical matter, Kodak's central legal argument: that its pricing of parts and service simply *cannot be* the result of market power because the equipment market is competitive. And, in any event, the claims, far from being self-evidently true, raise obvious factual questions—indeed, are dubious even on their face.

Kodak first asserts that, by preventing customers from using ISOs, "it [can] best maintain high quality service for its sophisticated equipment" and avoid being "blamed for an equipment malfunction, even if the problem is the result of improper diagnosis, maintenance or repair by an ISO." Kodak Br. 6-7. Aside from the fact that Kodak has offered no evidence to indicate that ISOs have been providing "inferior" service or that Kodak was actually

[17] As noted above, Kodak does not argue the relevance of such defenses to respondents' tying claims. *See* note 9, *supra*.

concerned about quality—and respondents have offered evidence to the contrary (J.A. 424-26; Lodgings 126, 133)—Kodak's suggestion is counterintuitive. To overcome the natural competitive advantage that Kodak has in the service market for *its* products, an ISO would have to be more efficient, not less. It is also particularly ironic that Kodak would suggest that its customers are too unsophisticated to avoid inferior service when its basic argument is that these same customers are sophisticated enough to make complex and subtle lifecycle-pricing decisions and thereby prevent Kodak from taking advantage of its monopoly. There is no reason why informational sophistication should be present in one circumstance and absent in another. In any event, Kodak's argument hardly seems consistent with its own policy of exempting self-service customers, who might also develop "inferior" service and who, if anything, are more likely to blame Kodak's equipment if their own employees cannot fix it.

Kodak's second justification—controlling inventory costs—is even more patently suspect. The simple fact is that the inventory of parts needed to repair Kodak machines should turn only on breakdown rates. Those rates should be the same whether Kodak does the repair or ISOs do it.

Kodak's argument about preventing free riding is likewise questionable, at least in this case. In Kodak's view, apparently, "free riding" can be invoked whenever a product creates derivative markets—*e.g.*, without copiers, there would be no service market—and can entitle the manufacturer of the product to insist on a monopoly in *all* derivative markets—*e.g.*, gasoline for cars, home repairs for houses. But that view has nothing to do with the concept of free riding that this Court has discussed in prior antitrust cases, such as *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), which is relied on by Kodak.[18] Rather, free riding could be relevant here

[18] *GTE Sylvania* involved a manufacturer's policy of restricting the number of retailers that could sell its product. In that con-

only if Kodak were absorbing a cost in one market and then seeking to recoup the loss by above-cost pricing in a derivative market. In that situation, Kodak's overall lifecycle price might be competitive and ISOs might be "free riding" on Kodak's loss-generating investment in creating the derivative market.[19] But even if such a claim could justify a tying arrangement, for example, rather than lead to an insistence on cost-based pricing in the primary market, it is not at issue in this Court.

Most significantly, Kodak itself has never claimed that it has subcompetitively priced its equipment or parts (*i.e.*, priced them below marginal cost), even though the factual evidence to support such a claim (if it were true) would be readily available to Kodak. Certainly, this Court cannot simply assume that Kodak is doing so and award summary judgment on that basis. Indeed, such an argument is facially inconsistent with the fact that Kodak allows its customers to service their own products. If a free-riding theory applied here, Kodak would have to be losing money on its self-service customers, because it is not receiving any service revenues from them to recoup its parts and product losses—unless, of course, Kodak is engaging in price discrimination by charging such customers *more* for equipment or parts than it charges other customers. Not surprisingly, Kodak has not made any such claim. Free riding, in short, is not an issue here.

text, the Court explained, the policy served the procompetitive goal of allowing new manufacturers to "induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer." 433 U.S. at 55. Without a restriction on retailers, however, "these services might not be provided" because any retailer could free ride on another's efforts. *Ibid.*; *see also Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762-63 (1984).

[19] The United States, stating that "resolution of [Kodak's] business justification issues [is] unnecessary" (U.S. Br. 24 n.23), relies on this theory throughout its brief in arguing that the Court should not be concerned about the undisputed fact that ISOs charged significantly less than Kodak for service. *Id.* at 14-15 & n.12, 18 & n.16. Specifically, the United States says that Kodak may be following a "marketing strategy of spreading over time the total cost to the buyer of Kodak equipment" (*id.* at 18)—in other words, charging below-cost prices for its initial equipment and then making up the difference by charging supercompetitive prices for service, with an overall price that is competitive. As explained in text, the government's theory is not merely speculative in general but insupportable on the evidence in this case.

CONCLUSION

Kodak's argument should be rejected, and the judgment of the Ninth Circuit affirmed.

Respectfully submitted,

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